

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Dated: 19.02.2002

Coram:

The Honourable Mr.Justice V.S.SIRPURKAR

and

The Honourable Mr.Justice K.RAVIRAJA PANDIAN

Tax Case No. 459 of 1996

The Commissioner of Income-tax,
Coimbatore .. Applicant

Vs.
M/s.N.M.Associates,
Coonoor .. Respondent

Reference under Section 256(1) of the Income Tax Act, 1961 against
the order of the Income Tax Appellate Tribunal, Madras Bench 'B'
dated 9-2-1996.

! For Applicant : Mr.T.Ravikumar
Jr.Standing Counsel for
Income-Tax

^ For Respondent: Mr.P.P.S.Janardhana Raja
for M/s.Subbaraya Aiyar

: O R D E R

(The Order of the Court was made by V.S.Sirpurkar,J) The
question referred to us is:-

"whether, on the facts and in the circumstances of the case, the
Appellate Tribunal is right in law in holding that the profits in respect
of hotel contract should be computed on project completion method?".

2. The following facts will highlight the grievance:- The
assessee is in the business of building and construction. It is an
unregistered firm. It takes contracts for construction. During the
assessment year 1984-85, the assessing authority found that there were no
accounts much less proper accounts maintained by the assessee. In the
returns, initially a loss of Rs.21,557/- was shown and thereafter by
another return, a loss of Rs.24,935/- was shown. The assessee firm used
to take small contracts as well as big contracts. At the relevant time,
there were some small contracts which were completed more or less in a

year or some times spilled over an year, while there was one big contract worth Rs.30 lakhs for construction of a hotel, which was to continue from year to year and was not completed in one year. Before the Assessment Authority, the assessee gave in writing that it was not possible for them to complete the account books and that they were trying everything to complete the same. The Assessing Authority observed on that that this letter was written in the month of November and therefore, it was clear that the assessee had not completed the accounts even upto November 1985, for the Assessment year 1984-85. A deposition was also taken by the assessing authority, who found that there were no day to day maintenance of accounts and therefore, the assessing authority came to the conclusion that the profits from the return could not be ascertained. He, therefore, recorded the following finding:-

"In the absence of day to day books of accounts and check on consumption of materials and also taking into consideration that the fact that the contract business had become competitive and the price of materials had gone up from day to day, I estimate the profit after allowing the depreciation at Rs.3,34,345/-"

This order was appealed against before the Commissioner of IncomeTax (Appeals). The Commissioner of Income-tax, however, came to the conclusion that the contention raised by the assessee that it is only on the completion of the contracts that profitability or otherwise of the same can be judged was not correct. It was also argued before him that the assessee can take up any method of accounting and therefore, the assessee was entitled to suggest that the accounting should be done only after the completion of the contracts and it is only on that basis, the profits earned or otherwise should be determined. The Appellate Authority, however, came to the conclusion that in so far as the smaller contracts were concerned, the method adopted by the assessee should not be disturbed in the sense that the profitability of those small contracts could be assessed only after their completion. However, in so far as the big contract of Rs.30 lakhs was concerned and which contract was spread out in more than one year, there should be a year to year assessment on the basis of ad-hoc profits and by calculating the profits on the basis of the percentage of the receipts received in a particular assessment year. Accordingly, he directed the ITO not to disturb the appellant's method of accounting in so far as various smaller contracts are concerned. However, regarding the long drawn hotel contract was concerned, the assessing officer was directed to assess the profit on ad-hoc basis at 5% of the gross receipts, instead of 8% as estimated by the assessing officer and on completion of the final tally to grant a set off for the ad-hoc profits assessed from year to year. This was questioned by the Revenue before the Tribunal. While, the assessee also filed cross objection in so far as the direction regarding the bigger contract of Rs.30 lakhs and the method of computation for the profits as ordered by the Appellate Authority. The Tribunal came to the conclusion that under law, the assessee was entitled to maintain his accounts in any manner he liked, so long as it was a correct and acknowledged method of accounting. The Tribunal came to hold on the basis of a book called "Accounting for construction contracts" and more particularly, the contents in "Accounting Standard 7" of the Institute of Chartered

Accountants of India that it was permissible to assess the profits in respect of contract only after the said contract was completed. The Tribunal also accepted its decision in case of one M/s.Heeral Constructions Private Limited. Dismissing the said claim and allowing the assessee's appeal, the Tribunal disapproved of the decision of C.I.T(Appeals) and directed the assessing officer to determine the profits only on the year of completion of the project. We have already quoted the question which has been referred to us and it is clear therefrom that we would not be concerned as to what happened with the smaller contracts which have been directed to be assessed on the basis of their completion. We will be only concerned with the bigger contract of Rs.30 lakhs, in which a direction has been given to assess it on the yearly basis and more particularly on the receipts received every year.

3. Learned counsel appearing on behalf of the Revenue firstly contended that the Tribunal was completely in error in allowing the cross objection filed by the assessee. Learned counsel argued that all that was possible only if there were any accounts properly maintained by the assessee. Learned counsel pointed out that it was the admitted case that proper accounts were not maintained at all by the assessee and that there was no way to know the day to day transaction regarding the receipts or regarding the spendings. Under the circumstances, the contention raised by the counsel was that there was nothing wrong if the said contract was directed to be judged on year to year basis. As regards the finding pertaining to the bigger contract of Rs.30 lakhs and more particularly as regards the direction given by the Tribunal, learned counsel pointed out that the question was no more res integra and that the Tribunal had ignored the fact that in this case no accounts were available at all. Our attention was invited to the decision reported in TIRATH RAM AHUJA P. LTD Vs. C.I.T DELHI (103 ITR page 15), which is the decision rendered by the Delhi High Court. The High Court in that case was dealing with the assessee who was engaged in the business of construction contracts. It found that, that the contract had remained incomplete and therefore, it came to hold that in case of contracts, it was not necessary to wait till the contract was completed in order to ascertain the income and that it was open to the revenue to estimate the profit on the basis of the receipts in each year of construction, although the contract was not complete. That was also a case where the contract spilled over one year to another year and was not completed within the period of 18 months, which was the initial term of the contract. The Delhi High Court also relied on a decision reported in SUKHDEODAS JALAN Vs. COMMISSIONER OF INCOME TAX(26 ITR 617) and found that in the aforementioned case a military contract extended beyond the accounting period and the accounts were closed only after the completion of the contract. The Court had held that merely because the contract was completed after the accounting period, it could not be presumed that no profits arose or accrued to the assessee in the accounting year and that in the case of an incomplete contract, there is a well established method of calculating profits accruing in the accounting year, which was pointed out in Batliboi's Advance Accounting. Learned counsel further pointed out that this decision was later on confirmed by the Supreme Court also in TIRATH RAM

AHUJA P. LTD Vs. COMMISSIONER OF INCOME-TAX, NEW DELHI (186 ITR page 428). Thus, it was obvious that the Apex Court has approved the method of yearly accounting in case of contracts.

4. The case herein is even worse. There are no proper contract accounts whatsoever. Therefore, there was no way in knowing as to what were the receipts and the spendings on the part of the assessee. Therefore, if the Commissioner of Income-Tax adopted the method of yearly accounting in pursuance of his powers under Section 144 of the Act then there was nothing wrong. The Tribunal has clearly gone wrong in ignoring the fact that in this case there was no accounting at all and the method suggested by it can stand justified only if there were proper accounts maintained by the assessee.

5. Learned counsel Mr.P.P.S.Janardhana Raja tried to point out that while the method of completion of contract was adopted in case of smaller contract, same could have been done in the case of bigger contract also. All his criticism could have been justified had there been properly maintained accounts. In the absence of that, the authorities were bound to follow the accepted method of calculating the profits on yearly basis, which the Appellate Authority had done. In our opinion, the order of the appellate authority was a correct order and the order of the Tribunal holding contrary and introducing method of calculating profits only after the completion of the contract is not correct and justified. We accordingly answer the reference in favour of the revenue and against the assessee.

Index:Yes/No (V.S.S.J) (K.R.P.J)

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19.02.2002

To

1. The Assistant Registrar
Income-Tax Appellate Tribunal
III Floor, Besant Nagar, Chennai

2. The Secretary
Central Board of Revenue
New Delhi.

3. The Income-Tax Officer
Circle-I (1) Ooty

4. The Commissioner of Income-Tax(Appeals)
Coimbatore

V.S.SIRPURKAR,J

and

K.RAVIRAJA PANDIAN,J

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